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How the Fed's expected interest rate cut may affect client portfolios
By Rob Burgess
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For quite a while now, financial advisors and analysts have been waiting to see when the Federal Reserve would finally lower interest rates. The federal funds rate is currently at 5.25% to 5.50%, the highest in over two decades.

The Consumer Price Index (CPI) through July, released Wednesday, offered some hope on that front. The annual inflation rate came in at just 2.9% — the smallest 12-month increase since March 2021.

Lindsay Rosner, head of multi-sector fixed income at Goldman Sachs Asset Management,said this meant that "the relay race to Fed cuts" was on track, clearing the way for a 25 basis point cut in September, "while not completely shutting the door on the chance of a 50 basis point cut."

Bret Kenwell, U.S. investment analyst at trading and brokerage platform eToro,said investors should feel more confident in a September rate cut.

"However, it's no longer a question of 'if' or 'when' the Fed will cut rates, but rather, whether the Fed will cut by 25 or 50 basis points," he said.

Ronald E. Lang, principal and chief investment officer at Atlas Wealth Management in Phoenix, said with the increasing likelihood of at least a 25 basis point cut next month, "It doesn't do much to the average citizen, but it is psychological that this is the beginning of several more cuts which will eventually have an effect."

"Overall, the psychology of a minor rate cut will create gyrations in the market, but if there are significant cuts or continuous cuts in several consecutive meetings, that means the economy took a turn for the worse," he said. "Easing rates down over time without a major catalyst to the markets creating panic is the way to go for the Fed."

When the Federal Reserve begins to cut rates, financial advisors say that would also signal changes in how they allocate client portfolios over the coming months.

Easing rates, but slowly
Chris Diodato, founder of WELLth Financial Planning in Palm Beach Gardens, Florida, said the Fed has "a big challenge" as "the effects of monetary policy can take up to two years to be fully felt in the economy."

"An interest rate cut today isn't immediately going to spur economic growth," he

said. "It will take some time. This is why market participants are so concerned about the Fed falling behind the curve. If the economy is rapidly slowing down and the Fed isn't cutting rates yet, it may be impossible to avoid a recession. Thankfully, economic data and our analytics don't suggest this is currently happening."

David Flores Wilson, the managing partner of Sincerus Advisory in New York, said he expects a sustained period of easing rates, potentially into 2026.

"It will likely take a while, but the massive amounts of cash earning 5% in savings accounts and Treasury Bills could get deployed into overlooked segments of the markets, including foreign markets, small-cap stocks and bonds," he said. "With lower rates, many families will be able to take the next stage of their plans, as a low interest rate mortgage on their existing home currently hamstrings them from moving to another home, whether it be for an employment opportunity or an expanding family."

Asset classes will react in their own ways

Diodato said the money market and short-term certificate of deposit rates essentially track the federal funds rate and should be expected to begin falling immediately after the Fed begins cutting rates.

"As for bonds of other maturities, I don't know if they'll become a 'hot' investment, but the headwinds the asset class has faced over the last three years are turning into tailwinds," he said. "For what it's worth, we've bought into more long-term bonds for clients as these bonds tend to benefit most from falling interest rates."

Other asset classes, however, are trickier, said Diodato.

"Stocks and real estate values are economically sensitive, and economic growth is moderating," he said. "If the Federal Reserve engineers an economic 'soft landing' and sidesteps a recession, then certainly stocks and real estate should perform wonderfully. But, if the economy blinks, you would expect some decline in stock and real estate prices."

Collin Lyon, a financial advisor with Anderson Financial Strategies in Dayton, Ohio, said projecting a conservative 2% total cut of the rate over the next two years, he expects double-digit bond returns over that period. He said real estate investment trusts (REITs) have also accumulated a lot of built-up power, which could be unlocked as interest rates go down.

"Both look great and could function much like a coiled spring," he said. "I stress the importance of diversification among both asset classes to take advantage of the potential opportunity rather than saying one is better than the other."

However, Jason Britton, founder and CIO of Reflection Asset Management in Charleston, South Carolina, said he thinks real estate "has some structural

defects, at least in the office market in a post-pandemic world."

"Too many people have been chasing housing, specifically multifamily housing, that is only going to get more crowded as a trade if rates come down," he said.